7 The financial system

The 1931 crisis and demise of the Labour government stimulated a radical reappraisal of Labour's whole approach to policy, especially economic policy. In the area of financial and monetary policy this concern to rework Labour's positions was driven not only by the general belief that the problems of 1929–31 had been in part a policy failure but also by the belief that the collapse of 1931 had flowed directly from a combination of the malevolence of financial institutions towards a Labour government ('the bankers' ramp') and weaknesses in Labour's understanding of those institutions. Hence, central to the Labour policy review of the 1930s was the reformulation of policy on money and finance, a review led by Hugh Dalton.[1]

This policy review ranged over most aspects of domestic monetary and financial policy – from how to secure price stability, the desirable exchange rate regime, through to specific proposals for institutional reform of the financial system. The focus of this chapter is the latter area, for two reasons. First, the problems of monetary policy have been exhaustively dealt with in recent work by Susan Howson.[2] Second, the striking feature of the 1940s is the extent to which all the debates of the 1930s seem to have had so little impact in the following decade. In an area where, arguably, Labour was as well prepared with detailed policy proposals as any, the actual experience of government after 1945 was that all these efforts yielded meagre results.

Between 1931 and 1945 most Labour and other progressive policy discussion assumed that radical reform of the financial system was required, and all Labour politicians assumed such reform would be cen-

[1] Durbin, *New Jerusalems*, ch. 10. Many of the Labour Party experts on these areas contributed to G. D. H. Cole, ed., *What Everybody Wants to Know about Money* (1936), which, whilst written in textbook form, represents much of Labour Party thinking by the mid-1930s. In this area Labour developed links with (a small number of) City experts via the XYZ Club, founded in 1932 (Durbin, *New Jerusalems*, pp. 81–3, 209–10).

[2] Howson, *Monetary Policy*.

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tral to Labour's policies in office. As Brooke[3] stresses, 'the control of finance was perceived as the handmaiden to the socialisation of industry'. Three proposals for such reform were interwoven in Labour's statements in the 1930s and 1940s – nationalisation of the Bank of England, nationalisation of the joint-stock banks and a National Investment Board (NIB).

This chapter focuses on why so little came of these proposals, especially the NIB.[4] The NIB deserves this attention on a number of grounds. First, it was a proposal which had widespread support in the 1930s, well beyond Labour Party circles and into the wider fields of 'progressivism'. Second, such a board would seem to fit in with Labour's post-1945 concern to plan the economy, in which the planning of investment was generally accepted as crucial. Third, the failure to establish the NIB was the cause of dissension under Labour, and the debate over the failure to implement the proposal brings out some of the tensions in Labour's attempts to run the British economy in a new way after 1945.

Nationalisation of the Bank of England

The first of Labour's proposals from the 1930s may be dealt with briefly. By the 1920s Labour's leadership already supported the idea of nationalising the Bank of England. At various times in Labour's past this proposal had been put forward, and in 1928 it was embodied in the major policy statement, *Labour and the Nation*.[5] However, at this time, at least as far as the leadership of the party was concerned, this nationalisation would involve no significant policy departure. Given the Bank's central role in the financial system it was argued, it was right that it should be nationalised, but Snowden, Labour's spokesman on finance (and Chancellor of the Exchequer in the Labour governments of 1924 and 1929–31), stressed that nationalisation would have to be done by a means which secured the Bank from any political control. In this, as in so many other areas, Snowden was a vigorous supporter of financial orthodoxy. He explicitly repudiated using the nationalised Bank as a means either

[3] Brooke, 'Revisionists and Fundamentalists', p. 160.

[4] Howson's primary concern is with monetary policy, but she touches on the failure of Labour significantly to reform the financial system (*Monetary Policy*, chs. 2, 3).

[5] S. Pollard, 'The Nationalisation of the Banks: The Chequered History of a Socialist Proposal' in D. E. Martin and D. Rubinstein (eds.), *Ideology and the Labour Movement* (1990), p. 172.

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of macroeconomic management or of microeconomic planning, as advocated especially by the Independent Labour Party in the 1920s.[6]

After the collapse of 1931 the desire to nationalise the Bank was strengthened by its alleged role in the so-called bankers' ramp which led to the collapse of the Labour government. In addition, the nationalisation appealed to a Labour Party searching for specific economic policy instruments to replace the windy rhetoric of socialism so prevalent in the 1920s. Nationalisation of the Bank became part of the agenda not only of the Labour Party but other 'progressive' forces as Keynesian-style macroeconomic management became an influential force under the impact of the mass unemployment of the 1930s. Keynes himself came to see nationalisation of the Bank as one condition for an active monetary policy.[7]

The nationalisation of the Bank gained support across the spectrum of views in the Labour Party, and was embodied in the major 1930s policy statement, *For Socialism and Peace*. In this case at least there was a unanimity of approach which ensured that the nationalisation of the Bank was one of Labour's earliest legislative acts after 1945. Symbolically important for Labour, it is doubtful whether this nationalisation made much practical difference, especially to the relations between a Labour government shorn of the hair-shirt financial orthodoxy of a Snowden, and the Bank without a dictatorial but guileful Montagu Norman. It was the combination of these two people and their approach to monetary policy which had made the Bank's activities seem so unacceptable to the vast majority of Labour and progressive opinion in the 1930s. But the post-1945 situation is well described by Lord Bridges, Cabinet Secretary under Attlee:

> QUESTION: What practical difference in working between the Treasury and the Bank resulted from the Act of 1946?
> BRIDGES: . . . I should have said very little . . . when the Government wanted to get on top they could always do so, but in the old days it might mean a good deal of fuss to get there. The Act merely meant that the Government could get on top more easily and *de jure* without having a fuss.[8]

Recent work has tended to be less complacent than earlier research about the relationship between the newly nationalised Bank and govern-

[6] Ibid., pp. 172–3.
[7] Durbin, *New Jerusalems*, p. 268.
[8] (Radcliffe) *Committee on the Workings of the Monetary System*, Minutes of Evidence Q.12558, HMSO 1959. Robin Marris records it being a popular joke in the 1950s that the key to changing the machinery of economic policy would be to nationalise the Bank of England (*The Machinery of Economic Policy* (1954), p. 25).

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ment established by the 1946 Nationalisation Act. The precise measure of Treasury control over the Bank's decisions on monetary policy remained vague, and did not give the government the unambiguous powers that many proponents of nationalisation had anticipated.[9]

As Howson shows, the Governor of the Bank of England, Catto, fought an effective battle at the time of the framing of the nationalisation Act to limit the power of the Treasury to 'direct' the Bank, and to protect the Bank's informal relationship with the clearing banks. Despite what seems to have been the perception of ministers, including Dalton, at the time, the legislation put very tight constraints on the capacity of the government to influence clearing bank behaviour, though this did not clearly emerge until a legal opinion was taken in 1951.

The result of the nationalisation, as Fforde suggests, was to continue rather than resolve the ambiguous status of the Bank in relation to monetary policy, and to maintain the Bank's role as a spokesman for the City to government at least as much as an instrument of government policy *vis-à-vis* the City.[10] As so often, Labour seems to have been satisfied with a symbolic rather than substantive reform of a major institution.

Nationalisation of the clearing banks

The proposal to nationalise the clearing banks has been well analysed by Sidney Pollard. As he points out, the proposal has been periodically put forward as a Labour Party policy, and gained widespread support in the early 1930s as part of the Labour perception of the clearers' role in the 1931 debacle. At the 1932 Labour conference a motion to pursue such a nationalisation was embodied in Labour's policies, despite opposition from most of the party leadership. It was subsequently included in *For Socialism and Peace*, and was part of Labour's policy at the 1935 general election.

But after the general election defeat the proposal disappeared. In part this was an aspect of Labour's general reassertion of its 'moderation' in the face of continuing electoral unpopularity. But perhaps more significantly, it reflected the growing weight in Labour circles of those who emphasised the macroeconomic aspects of financial policy. For Labour intellectuals like Durbin, nationalisation of the clearers became

[9] Howson, *Monetary Policy*, pp. 113–17; J. Fforde, *The Bank of England and Public Policy 1941–1958* (1992), ch. 1.
[10] Fforde, *Bank of England*, pp. 12–13.

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unnecessary if full employment could be secured by Bank of England regulation of general credit policy.[11]

As Pollard argues, support for nationalisation of the clearers had a range of objectives, and for many these included microeconomic as well as macroeconomic goals. For example, Radice argued that the nationalisation would make it possible for

> the distribution of credit to industry to be co-ordinated according to the general economic needs of the nation. Information could be pooled, industries could be dealt with as such and not as sets of isolated firms, and their reorganisation could be carried through in a way which would be impossible when the competing claims of firms on many different banking institutions have all to be taken into separate consideration.[12]

But despite such arguments, the nationalisation of the clearers had disappeared from official policy by the time of *Labour's Immediate Programme* in 1937, and reappeared in policy neither proposed nor carried out thereafter.

The National Investment Board

The third policy proposal prominent in the 1930s was that for a National Investment Board, though from the beginning there was little agreement on what exactly such a body might do or what other institutional changes might need to accompany it. The idea of an NIB seems to have been first explicitly put forward by the Liberals, in the Liberal *Industry Inquiry* of 1928, though similar proposals had been advanced by groups within the Labour Party, especially the Independent Labour Party earlier in the 1920s.[13]

Like the nationalisation of the Bank of England, an NIB became part of the 'progressive consensus' of the 1930s, rather than peculiarly a

[11] Pollard, 'Nationalisation', pp. 176–8; Durbin, *New Jerusalems*, pp. 155–6. See also E. A. Radice, 'Commercial Banks and Credit' in Cole, *What Everybody Wants to Know about Money*, esp. pp. 196–7.

[12] Radice, 'Commercial Banks', p. 197. This approach to the role of financial institutions reflected the widespread belief that these institutions should play a greater role in 'rationalising' staple industries. In fact, the main initiative in this came from the Bank of England, via the creation of the Bankers' Industrial Development Corporation and the Securities Management Trust (R. S. Sayers, *The Bank of England* (Cambridge, 1976), vol. 1, ch. 14). The Bank was also active in help for the Special Areas, i.e. areas of high unemployment. But as so often with the Bank, its role was limited and often aimed at pre-empting more radical initiatives by others, usually government (Carol E. Heim, 'Limits to Intervention: The Bank of England and Industrial Diversification in the Depressed Areas', *Economic History Review* 37 (1984), pp. 533–50).

[13] Liberal Party, *Industrial Inquiry* ('Yellow Book') (1928; republished 1978), pp. 111–15, though this proposal is unclear on how far the Board would regulate *private* investment; Durbin, *New Jerusalems*, p. 51; Pollard, 'Nationalisation', pp. 170–3.

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Labour proposal. However, whilst Keynes and the Liberals emphasised the macroeconomic aspect of the idea, most Labour supporters were also keen on the idea of its playing a microeconomic, allocative role. Labour's idea behind the NIB is well summarised by a proposal of 1931 which wanted such a body to 'control the amount and direction of home and foreign investment, to authorise new issues, to secure priority for enterprises of social importance and to assist in the work of National Planning'.[14]

At the 1932 Labour Party conference Hugh Dalton, by then the party's most important financial expert, moved the proposal to create the NIB: 'A National Investment Board is an essential instrument, in the opinion of the executive, in carrying out our policy of socialist planning. We must exercise control over the direction and over the character of new capital issues on the money market, and of new capital developments in different parts of the country, and in different industries.'[15]

In 1932, Labour published *Currency, Banking and Finance*, its most detailed discussion of the issues. This endorsed the NIB proposal, and spelt out how it would work. The document focused especially on control of new capital issues by the board: 'that with the object of preventing waste and misdirection in the use of long-term capital, the board should exercise control over all new public issues on the capital market, and its permission should be required before any such new issue could be made'. This was further spelt out in more specific terms: 'housing schemes should come before dog tracks, new plant for scientific treatment of coal before new plant for luxury trades'. The NIB, it was argued, 'should contribute, as it were, the general staff of the Government for planning and co-ordinating the mobilisation and allocation of that part of the national wealth which is destined for capital investment'.

Nicholas Davenport, who claimed to be the originator of the 1932 proposal, had actually called for *two* new bodies to be established. These were to be an NIB, which would focus on control of capital issues, and what he called an Industrial Finance Corporation which would *initiate* finance for both new and basic industries.[16] The latter part of the proposal might be seen as responding to the kind of concerns about the

[14] Durbin, *New Jerusalems*, pp. 207, 205. Keynes supported Labour's broad idea for the NIB, but wanted it to stick to 'quantitative' rather than 'qualitative' control of investment (J. M. Keynes, *Collected Writings*, vol. XXI (1982), pp. 133–7, 590–2). At the extreme right of the 'progressive consensus' Harold Macmillan, a future Conservative Prime Minister, supported the idea of an NIB in his *The Middle Way* (1938), pp. 260–4.

[15] Labour Party, *Annual Conference Report* 1932, p. 184.

[16] N. Davenport, *Memoirs of a City Radical* (1974), pp. 76–9, 246–9; H. Dalton, *Memoirs*, vol. I, *The Fateful Years* (1957), ch. I.

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British financial system articulated by the Macmillan Committee, which reported in 1931. It famously noted the existence of a 'gap' in the financial system in equity provision for small business. But in fact its criticisms of the system went much wider than that with the assertion that 'there is substance in the view that the British financial organisation concentrated in the City of London might with advantage be more closely co-ordinated with British industry'.[17]

However, this second aspect of financial reform tended thereafter to be neglected by Labour in the 1930s though *some* on the left continued to discuss the issue.[18] The creation of the Finance Corporation for Industry and the Industrial and Commercial Finance Corporation in the last period of the Second World War reflected the Bank of England's desire to pre-empt a more radical change in the financial system which a possible future Labour government might pursue.[19] Much later, in 1966, a Labour government created the Industrial Reorganisation Corporation, with a remit of encouraging mergers in British industry, in the hope that this would create large, efficient 'national champions'. Few would regard that policy as a notable success.[20]

The NIB proposal as spelt out in the 1932 document seems quite clear and straightforward, if rather general, until one also looks at what was explicitly exempted from the board's remit: 'The Board would not deal with the private investment of savings in private business, nor with the re-investment of undistributed profits by public companies in their own businesses, nor with the operations of municipal banks, building societies, co-operative societies or other bodies operating under the Industrial and Provident Societies Act.'[21] The limitation imposed on the NIB role in respect of investment of undistributed profits was to be a crucial problem after 1945, as discussed in the next section. The NIB approach to investment control implied that new issues would be crucial to the overall pattern of investment, an assumption already quite unjustified in the 1930s and to be further undermined by events in the 1940s.

The NIB proposal was embodied in *For Socialism and Peace* and became a staple of 1930s statements of policy by leading Labour figures, not least Dalton, who detailed its central role in Labour's plans for con-

[17] (Macmillan) *Committee on Finance and Industry* (1931), paras. 397–403.
[18] Howson, *Monetary Policy*, pp. 69–71.
[19] Fforde, *Bank of England*, pp. 704–26.
[20] D. C. Hague and G. Wilkinson, *The I.R.C.* (1983); Tomlinson, *Government and the Enterprise*, ch. 10.
[21] Labour Party, *Currency, Banking and Finance* (1932), pp. 2, 9, 10.

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trolling 'long-term credit' in one of the major statements of Labour doctrine of the decade.[22] The proposal survived largely unaltered into the war period. It was embodied in *Full Employment and Financial Policy*, Labour's major wartime statement on economic policy; in the important TUC document 'Interim Report on Postwar Reconstruction' in 1944; and in the 1945 general election manifesto *Let Us Face the Future*, which said that under a Labour government 'planned investment in essential industries and on houses, schools, hospitals and civic centres will occupy a large field of capital expenditure. A National Investment Board will determine social priorities and promote better timing in private investment.'[23]

Yet despite all this background, the proposal came to almost nothing after 1945. A wartime Capital Issues Committee was continued under Labour (and, indeed, through most of the 1950s), but its impact was minimal. Dalton, Labour's first Chancellor, created a National Investment Council, but this was very limited in scope, focusing on such questions as bonus issues of shares, and faded away after a few meetings. Beyond this nothing was done.[24] In this area the 'progressive consensus' of the 1930s bore no fruit at all.

The NIB and the control of investment

Labour's failure to establish an NIB was a cause of considerable debate in the Labour Party after 1945. Most of this came at the time of Dalton's proposal for establishing a National Investment Council. From the beginning he was aware that this proposal fell far short of the idea of an NIB. The council was advisory in form. Its remit was supposed to include offering general advice on investment policy. At its first meeting Dalton spoke of its aim as being to see that 'the financial machinery is geared in with the general economic plan of campaign', but this agenda quickly narrowed to a focus on the minutiae of new issues.[25]

[22] Dalton, *Practical Socialism*, ch. 22; T. Burridge, *Clement Attlee: A Political Biography* (1985), p. 86.

[23] Labour Party, *Full Employment*; TUC, 'Interim Report on Postwar Reconstruction', in *Report of the Annual Congress of the TUC 1944*, esp. pp. 430–1; Craig, *General Election Manifestos*, p. 126.

[24] Cairncross, *Years of Recovery*, pp. 446–7. The *Financial Times* (29 July 1946) commented sardonically on the NIC: 'For all the Council's high-powered wisdom, however, we are now told that it is not worth summoning to Whitehall more than once a quarter.'

[25] PRO T233/61, National Investment Council; PRO T228/81–3, National Investment Council, Minutes and Memoranda. Curiously, in his memoirs, Dalton said the creation of the NIC stemmed from 'Tory requests when my Bank of England Bill was in Committee' (Dalton, *Memoirs*, vol. II, *High Tide and After* (1962), p. 96).

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However, even this proposed broad advisory role was much less than many in the party had anticipated. In the Cabinet meeting discussing the proposed NIC, Dalton said:

> Its function would be advisory and not executive. In this respect it would differ from the NIB which had long formed part of the Labour Party programme; but the position was different now that a Government was in power which was ready itself to take positive action to plan the use of the nation's economic resources. In present circumstances executive functions with regard to the control of investment should be exercised by the Government itself.[26]

At a prior ministerial discussion of the bill, Morrison in particular had stressed the limited scope of Dalton's proposals. He stressed that, 'while the Bill would provide an effective weapon for controlling borrowing, it did not touch the equally important problems of how to control the reinvestment by industry of reserve funds and undistributed profits'. In response, Dalton argued that the latter issue should be dealt with by the control of physical resources, a matter, he argued, primarily for the Board of Trade.[27] When the Bill came to the House of Commons debate, Dalton came under much stronger pressure, largely from his own side of the political divide.

In introducing the Investment (Control and Guarantee) Bill he spoke of it as 'a simple, short, modest measure . . . It will give the government a small but useful addition to their sets of tools for economic planning.' He emphasised that the financial controls (i.e. the Capital Issues Committee) envisaged in the Bill would *supplement* physical controls.[28] He went on to say why this was being introduced as an alternative to the NIB, which he noted had been advocated by the 'Yellow Book' and the Minority Report of the Macmillan Committee in 1931, and also, in a marvellous piece of selective memory given the historical background sketched above, he said: 'some members of the Labour Party have advocated it from time to time'. Now, he argued, the government had moved beyond that conception. The key point he argued was one of Cabinet responsibility: 'The Cabinet, subject always to the approval of the House of Commons, must be responsible, and is prepared to be held responsible, for economic and financial planning in this country. The Cabinet cannot delegate its Ministerial responsibility in these matters to any independent or semi-independent Board.'[29]

[26] PRO CAB128/2, Cabinet Conclusions CM55(45), 22 Nov. 1945.
[27] PRO CAB71/19, Lord President's Committee Minutes, 1 Nov. 1945.
[28] *Hansard* (Commons), vol. 418, cols. 1547, 1551, 5 Feb. 1946. During the Bill's progress it became the Borrowing (Control and Guarantee) Act, which more accurately summarised its purpose.
[29] Ibid., cols. 1556–7.

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The most effective critic of Dalton's proposal was Christopher Mayhew. He argued that any attempt to control investment by controlling borrowing would be ineffectual. As he pointed out, only about one-eighth of investment was financed from borrowing, the rest from ploughed-back profits and other internal funds. The Bill, he said, 'controls the borrowing but not the spending of money. It is a different matter to control borrowing and to control investment.' Mayhew accepted that for the time being the other seven-eighths of investment was subject to physical controls. But he noted that everyone assumed these controls would be temporary, and the need was to develop comprehensive investment control for the period *after* those physical controls disappeared. His positive proposal was for capital budgets above a minimum level of £25,000 to be drawn up by all companies, and to be subject to control by an appropriate planning authority. Such controls would replace financial controls and provide a long-term basis for investment control.[30]

Mayhew's arguments went to the heart of the issue. The pre-war NIB had been proposed in a context in which government control over investment was extremely limited. By 1945 this had, of course, changed out of all recognition, with the imposition of controls on labour, machinery, building and materials allocations forming a comprehensive system by which government had an unprecedented capacity to determine the volume and direction of investment. Labour, strong advocates of 'planning' in the 1930s, now found themselves, thanks to the war, with systematic controls over investment (and other facets of the economy), which raised the key issue of how far these controls represented the permanent instruments of that desired planning regime.

There was no unanimous view on this issue in the Labour Party, and a complex and confused debate around it continued through the late 1940s. But, as Mayhew recognised as early as November 1945, there would be very strong pressures for many of these controls to be abolished as the supply shortages which underlay them disappeared. These supply constraints acted to give practical force to controls, but also gave them political legitimacy. Once the supply problem was reduced, however, the practical and political pressures to reduce controls were irresistible. That, broadly speaking, was what occurred.[31]

[30] Ibid., cols. 1606–12. Mayhew had been a major exponent of the idea of the NIB in the 1930s, and had recognised at that time that an effective board would have to go beyond control of new issues (C. Mayhew, *Planned Investment*, Fabian Research Series 45 (1939), esp. pp. 35–6).

[31] See chapter 6.

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Table 7.1 *Composition of investment, 1948/9*

	%
Direct central and local government	25
Nationalised industries (including iron and steel)	25
Industries closely supervised by the government (agriculture, shipbuilding, petrol)	15
Manufacturing	20
Remainder (e.g. commercial)	15

Source: PRO T230/143, Economic Section, 'Alternative Methods of Controlling Investment'.

The erosion of physical controls still left the government with considerable powers in the investment field. Calculations for 1948/9 (table 7.1) suggested that one-quarter of investment was by central and local government, another quarter directly in the hands of nationalised industries, and another 15 per cent in areas where government had a very large influence. Nevertheless, this left 35 per cent of investment, and crucially most of manufacturing investment, increasingly unregulated as the physical controls were run down.

As Mayhew had indicated, the link between borrowing and investment was a small one. His estimate of one-eighth of company investment being financed from borrowing is not dissimilar to subsequent calculations which suggested that around 80 per cent of investment at the end of the 1940s was from internal funds (table 7.2).[32]

Table 7.2 *Sources of corporate investment finance, 1948*

(£m.)

New issues	300
Bank advances	125
Depreciation allowances	825
Undistributed profits	500
Reserves	250
Total gross investment	2,000

Source: PRO T230/143, Economic Section, 'Alternative Methods of Controlling Investment'.

[32] B. Tew and P. D. Henderson, *Studies in Company Finance* (Cambridge, 1959), suggest a figure close to that in Table 7.2, though differences of definition make a precise comparison difficult.

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In fact, it is a long-standing feature of British companies that they finance their investment primarily from internal sources. But this was accentuated in the late 1940s by a number of factors. First, physical controls over investment in both the war and early post-war years left companies unable to invest as much as they wanted, so accumulating liquid reserves. Second, profits in the early post-war years were very healthy, reflecting the conditions of excess demand and easy markets. Finally, the tax regime at this time discriminated against distributed profits, so firms were given a substantial incentive to reduce dividend levels and retain profits in the business.[33]

This issue of the control of the use of ploughed-back profits was debated in the ministerial discussions prior to the 1946 Act establishing the National Investment Council. The Treasury was strongly hostile to any such controls, arguing that they would encourage higher dividends and be administratively very difficult to organise: 'it would require much more elaborate machinery to control than the Treasury has at present'.[34] These discussions do not suggest that ministers ever saw such controls as a serious possibility.

The actual pattern of investment control after 1945 was complex, with an excessive boom in 1945/6, more effectively curtailed from 1947, largely by physical controls. But as excess demand thereafter was reduced, those controls were relaxed. This led to a wide-ranging debate on the future control of investment within ministerial and civil service circles. A Committee on Control of Investment was established, which reported in 1949. This laid out the two aims of such control: 'to ensure that important investment was not swamped by less essential work, secondly, to lessen the danger that an excessive concentration of resources on investment would damage other sections of the economy, particularly exports, or render the inflationary problems insoluble'.[35]

It was recognised that physical controls had already been substantially run down, with the abolition of plant and machinery allocations in early 1946. Building controls, it was argued, were inappropriate for investment control because they had no direct relation to expenditure on plant

[33] Barna, ' "Frightfully High" Profits', pp. 213–26. This level of profitability seems to have been an unexpected feature of the post-war world. The Bank of England, for example, expected high taxation to reduce profits consistently as a source for investment after the war. Bank of England Archive, G14/155, 1968/2, *Financial Policy – Internal Committee on Post-War Domestic Finance*, 31 March 1943; Tew and Henderson, *Studies*, ch. 2.

[34] PRO T233/25, 'Borrowing (Control and Guarantees) Bill' 1946, Draft letter to President of Board of Trade, Nov. 1945.

[35] PRO CAB134/63, 'Committee on Control of Investment: Draft Reports', 1949, 23 July 1949, para. 1.

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and machinery, so in effect the controls relied on steel allocations, which would be eroded by the growth of steel output. The result, the report argued, would be that in the long run, 'So far as the investment by private firms and individuals is concerned, the methods of influence will inevitably be through general fiscal and financial measures'.[36]

The final report of this committee tried to be more positive about what could be achieved in this area without the use of physical controls. It accepted most control would be by fiscal and financial measures, but went on to point out that big firms have become accustomed to discussing their investment programmes with the government and hoped this would continue. It 'hoped' that the banks, and institutions like ICFC and FCI would conform to government guidelines in their lending policies. In conclusion, the report emphasised a consensual approach to the issue: 'Indeed, it is discussion and practical collaboration rather than specific measures of formal control or financial leverage which should be the keynote in dealing with the investment programmes of all sectors of the economy, whether socialised industries, local authorities, or private industry.'[37]

These conclusions seem to have been in line with the general movement of opinion in the government. The reasons for this may be looked at separately in the area of macroeconomic and microeconomic issues. As noted above, it envisaged that the NIB would have a role in both of these aspects, regulating the total level of investment (what may be called its 'Keynesian' function) and the allocation of such investment (what may be called its 'planning' function).

The macroeconomic function of investment controls may be schematically described as moving away from physical means towards general fiscal measures through the late 1940s. Whilst there was no simple transition from controls to Keynesian fiscal policy in the late 1940s, the second budget of 1947 did mark a clear movement towards emphasising the function of the budget in determining the level of aggregate demand in the economy.[38] This new role for peacetime budgetary policy did not immediately displace the physical controls in their macroeconomic role, but paved the way for such a displacement as the general aim of controlling demand was added to by the ending of specific shortages, notably that of steel.

Under Labour this fiscal policy was not accompanied by the use of monetary policy. As is well known, the government was initially committed to a cheap money policy and under Dalton this became a cheaper

[36] Ibid., paras. 6, 18.
[37] Draft report, 5 Sept. 1949, paras. 37–42, 51.
[38] See chapter 10.

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money policy, both to avoid raising the burden of the national debt and out of a general dislike of monetary stringency as a means of controlling the economy. In addition, Dalton saw cheaper money as a significant means of redistributing wealth by reducing *rentier* incomes. In addition, there were at the time many doubts about whether investment was very sensitive to small changes in interest rates.[39] But general budgetary policy was supplemented by investment allowances, revamped in 1945 in the form of initial allowances for plant and machinery of 20 per cent, later raised to 40 per cent.[40]

At the macroeconomic level it may be said there was a displacement of the proposed role of the NIB largely onto fiscal policy, or at least a clearly discernible trend in that direction under Labour. The government could reinforce that by its control or at least leverage over public sector investment, a leverage much greater than in the 1930s.[41] In that sense, the conditions of the 1940s may reasonably be said to have rendered an NIB redundant for control of the macroeconomy.

Much more problematic was the microeconomic, or 'planning' role envisaged for the board. It is important to note that almost all discussion in the 1940s assumed that government should have a role in the direction as well as the volume of investment. The question was, how was this role to be exercised. The Committee on the Control of Investment had raised the possibility of using the tax system in this investment allocation role. It held discussions with the Inland Revenue and Customs and Excise on this question, but was firmly rebuffed. These bodies argued, first, that the objective of the tax system was to raise revenue, not achieve other objectives. Second, they disliked any idea of discrimination in levying taxes between different firms, calling this a 'special case' approach, which would create all sorts of pressures from other taxpayers as well as threatening the revenue base. Finally, they pointed out that company taxation operated at the establishment level, which did not match any attempt to use the tax system to discriminate between industrial sectors. These views were accepted by the committee and by the government.[42]

[39] S. Howson, ' "Socialist Monetary Policy": Monetary Thought in the Labour Party in the 1940s', *History of Political Economy* 20 (1988), pp. 433–52 and more generally Howson, *Monetary Policy*. R. L. Hall and C. J. Hitch, 'Price Theory and Business Behaviour' (1937), reprinted in T. Wilson and P. W. S. Andrews (eds.), *Oxford Studies in the Price Mechanism* (Oxford, 1951), pp. 107–38.

[40] PRO CAB134/63, 'Report of Committee on Control of Investment', 5 Sept. 1949, para. 6.

[41] See chapters 5 and 13.

[42] PRO CAB134/63, Committee on Control of Investment, Minutes of 18 July 1949; ibid., 'Report' 5 Sept. 1949, para. 11. That it was so readily accepted by the government probably reflects the general unwillingness to operate a discriminatory industrial policy

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With physical controls progressively reduced in scope and discriminating fiscal devices ruled out, the focus on consensus and persuasion becomes understandable. Yet more radical alternatives were proffered, as has been noted already: for example, Christopher Mayhew had suggested a 'national budget' of investment, with governments exercising control of investment by a direct say in firms' investment decisions. Such a proposal raises a number of problems, which are perhaps best looked at in the broader context of the debate over 'planning' in this period.[43]

Planning became the key concept in progressive and Labour discussions of the economy in the 1930s, but its generality of use cannot disguise its often limited content (see chapter 6). It could embrace a vast range of ideas, extending from those of people who saw it as concerned with national income planning in the classic Keynesian sense, with the plan being about matching aggregate demand and supply, to those who wanted to emulate Soviet-style central planning. Most of the British debate fell between these two extremes, but in the 1940s there was a debate about where the balance should lie between national income and more microeconomic planning. Most of the senior advisers to the government saw the latter form of planning as desirable only as a transitional method in the restoration of some sort of equilibrium in the economy, and regarded almost complete reliance on national income planning as the long-term goal. This may be seen as the classic Keynesian view, based on the belief that, given full employment of resources, and with a given income distribution, the market could be left to allocate resources efficiently.

This was very much the view of James Meade, head of the Economic Section in 1945–6, who in 1945 produced a classic statement of the Keynesian case in a document entitled 'Economic Planning'.[44] This document stated that 'Planning should take place in terms of the broad categories of demand upon the community's resources', and stressed that whilst (especially in the transition period) the government could not be indifferent to what was happening in specific industries, and might try and influence it, by, for example, changing relative wages, 'Such action differs widely from the rigid planning of the output of particular industries'.[45]

for fear of upsetting the consensual co-operative approach to the private sector (J. Tomlinson, 'The Iron Quadrilateral: Political Obstacles to Economic Reform under the Attlee Government', *Journal of British Studies* 34 (1995)), pp. 90–111.

[43] For this context, see also J. Tomlinson, 'Planning: Debate and Policy in the 1940s', *Twentieth Century British History* 3 (1992), pp. 154–74.

[44] PRO CAB124/890, 'Economic Planning', 10 Oct. 1945.

[45] See chapter 8.

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In response to this, Mayhew wrote to the Lord President (Morrison), stressing that such a view made too many concessions to anti-planning views. He made similar points to those made in the House of Commons about the very limited impact of government planning by financial controls given the plentiful internal resources of companies. But he also argued that more could be done to guide the output structure, advocating something much more *dirigiste* than envisaged by Meade: 'A widely publicised National Plan, broken down into production targets for industrial factories, mines, etc., would be a good education in economics and an incentive to hard work.'[46]

But such views were those of an uninfluential minority in the late 1940s. Despite Meade's espial of Gosplanners elsewhere in the government and its advisers, a detailed look at the planning debates of the period shows little evidence of any such views amongst those who counted in policy-making.[47] The most important and articulate 'pro-planning' minister was Cripps, but his planning was much closer to a notion of 'tripartism' or 'corporatism', involving attempts to secure agreement on economic objectives with employers and unions via a large network of committees, than to any centralised, coercive economic planning. Centrally concerned with raising production and productivity, Cripps had little if any interest in the kinds of planning envisaged by people like Mayhew.[48]

Stephen Brooke has recently argued that 'Socialist planning was a notable, if unlikely casualty of Labour Government after the Second World War'.[49] This fate was partly conditioned by the vagueness which always attached to that concept. For a time planning came to be seen as synonymous with controls. But as the economic and political viability of these controls declined, little was found to put in their place. Whilst new planning bodies, the Economic Planning Board and Central Economic Planning Staff, were created in 1947, they did not reverse the trend towards decontrol. There was no wholesale rush to embrace Keynesianism in this period, but it seemed to offer a coherent alternative to the undoubted political problems of a more active governmental role in industry, and it formed the basis of much of the economic advice given to the government. It seemed to fulfil the promise of delivering full employment, which had been a major goal of planning, whilst largely excluding the need to find ways of determining the behaviour of private firms, many of which had in practice resisted any more than a formal

[46] PRO CAB124/890, C. Mayhew to Lord President, 13 Oct. 1945.
[47] See chapter 6.
[48] Tomlinson, 'The Iron Quadrilateral'.
[49] Brooke, 'Problems of "Socialist Planning" '.

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embrace of tripartism, and maintained their hostility to the Labour government's attempts to intervene in industry.[50]

The NIB must be viewed in this context. The board was part of that enthusiasm for planning of the 1930s. It was in some respects as vague in its content. Plainly it was envisaged to control new issues, but it was explicitly excluded from any role in investment from ploughed-back profits. This was a major problem, especially in the 1940s, when such profits overwhelmingly dominated the finance of investment. This would not have mattered if borrowing controls had been combined with the physical controls to provide an overall coverage. But whilst such linkage was vaguely hinted at by Dalton when he was making a case for the continuance of the CIC, in practice this never happened.

Partly this was because Dalton wanted to keep the roles of controller of physical and financial resources separate – as the ministerial discussions already noted make clear. Rollings has argued that this desire was strongly endorsed by the Treasury, which was quite happy with physical controls, because it believed they were widely recognised to be temporary, but hostile to any overarching control of investment by any such body as the NIB. For this reason 'Treasury officials desired to show that an NIB was unnecessary and undesirable'.[51]

Against the weight of Treasury advice alternative views seem to have had little weight. For example, the Labour Party Finance Group wrote to Dalton in 1946 about the weakness of the NIC in relation to the overall control of investment, and prepared a draft Bill to allow government control of *all* investment, however financed.[52] But these efforts seemed to have had no effect, and the same must be said of similar proposals to get a single body overseeing investment from the XYZ club and its influential members like Nicholas Davenport and Lord Piercy.[53] By July 1947, with the creation of the Economic Planning Board, the NIC was writing to Dalton saying, 'we take it that the NIC can no longer pretend to any surveillance of the national investment programme', and even that implies a larger role for the NIC in the preceding periods than seems justified by the evidence.[54]

[50] Mercer, 'Labour Governments'.

[51] Rollings, 'Control of Inflation', pp. 231–2.

[52] British Library of Political and Economic Science, LSE, Piercy Papers, 15/91, Letter from LP Finance Group to Chancellor of Exchequer, 4 April 1946.

[53] Ibid., 15/117 XYZ Correspondence, e.g. 'Suggested Reforms in Financial Machinery', Oct. 1948.

[54] Ibid., 10/64, Letter from NIC to Dalton, 22 July 1947; a similar line was taken by Cripps, who in writing to Lord Catto, the Governor of the Bank of England, in December 1948, said: 'during the past year important changes in the organisation for the scrutiny and control of the investment programme have been made, both within the machinery of government, and in contact with industry, through the Planning Board. I

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The failure of financial reform

Labour's policies on the financial system (in its external as well as its domestic areas) were remarkable for their mildness. Of course, there was the largely symbolic nationalisation of the Bank of England.[55] There was never a serious possibility of nationalising the clearing banks. New institutions in the 1940s were largely limited to the Industrial Commercial Finance Corporation and Finance Corporation for Industry. These were not creations of the Labour government, but of wartime Bank of England initiatives, spurred by the fear that the government's interest in reconstruction might lead to a direct government role in industrial finance. ICFC and FCI pre-empted this. The first aimed to fill the 'Macmillan gap' in finance for small firms. The latter had a much less clear role as a lender to 'special case' large firms.[56] Whilst the former played some part in bridging the gap at the small end of the market, neither of them addressed the broad critique of the limited links between British industry and the financial system which was articulated in the Macmillan Committee, and many other places in the inter-war period (and since).[57]

Other institutional changes were very limited. The Capital Issues Committee was continued, but its role was peripheral.[58] The broad priorities laid down for the CIC were backed by Bank of England persuasion of the clearing banks, but neither source of funds was very significant for industrial investment in this period. Banks in particular were keen to maintain their arms-length relationship from anything but a short-term role in industrial finance, and this was one reason for their support of ICFC.

The NIC, as we have seen, was never more than a talking shop, increasingly concerned with the details of new issues, and quietly faded away after a couple of years. Its role, as everyone recognised, was not even a pale reflection of that envisaged for the NIB.

think you will agree that these changes greatly reduce the field over which the NIC could effectively work' (Bank of England Archives G1/247 1396/2, 'National Investment Council'). Davenport, a member of the NIC, regarded its abolition as a 'victory for the Treasury Establishment': *Memoirs*, pp. 154–5. Dalton too 'regretted' the abolition (*High Tide*, p. 98).

[55] Durbin, *New Jerusalems*, p. 74.

[56] Fforde, *Bank of England*, pp. 704–26. The creation of ICFC and FCI was also urged on the Bank of England by the Treasury, eager to block more radical reform proposals emanating not only from the Labour Party but also the Board of Trade (e.g. Bank of England Archive G15/110 2503/1, 'Note on Discussion of Proposed Industrial Commission', 13 April 1944).

[57] (Macmillan) Committee on Finance and Industry, *Report*.

[58] Cairncross, *Years of Recovery*, pp. 444–5.

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The failure to pursue a more radical reform of the City, including the creation of a NIB, cannot be accounted for by any single reason. But three factors were important: the impact of the physical controls bequeathed to Labour by the wartime coalition, the strength of Keynesianism and the nature of industrial finance. The first seemed initially to offer an alternative way of planning the economy, and by the time their long-run unsustainability – at least on the microeconomic level – had been realised, the chance of radical innovation in policy in the direction of more permanently effective mechanisms had been lost. Keynesianism, in the sense of a body of ideas which presumed that full employment could be achieved without the necessity of a *dirigisme* that would be strongly opposed by employers, the Conservative Party, and most economists, had obvious attractions. Finally, the very distance between industry and finance in the British system proved an obstacle, in the sense that it was widely recognised that the investment decisions of most companies would be little affected by changes to the financial system. In the 1930s Dalton, along with many in the Labour Party had supported the NIB idea in the context of controlling long-term credit for industry: but in the 1940s industry had little need of such credit. In addition, the concern with industrial rationalisation which had animated much of the case for reform of the financial system in the 1930s was 'resolved' by nationalisation of industries like coal, railways, and iron and steel which had been the focus of much of the rationalisation debate.

In the 1930s Labour focused its attention on institutional reforms of the financial system, whilst in the 1940s the central financial issue was monetary control.[59] The 1930s attitude had drawn support from the generally depressed economic conditions, but also from widespread criticisms of the financial system, including those by industrial firms. However, there is little evidence of such criticisms in the late 1940s. A survey of the relevant Federation of British Industries records suggests that, when they approached the government on the issue of investment finance, the only matter the FBI were interested in was the taxation of profits, emphasising, as well they might in the circumstances, the role of ploughed-back, post-tax, profits in such finance. There was no articulation of a view that financial institutions were 'failing' industry.[60]

[59] Howson, ' "Socialist" Monetary Policy', p. 564; Howson, *Monetary Policy*, ch. 2.

[60] Warwick University, Modern Records Centre, Federation of British Industry Archive, e.g. MSS200/F/3/E3/8, FBI to Chancellor of the Exchequer, 'Taxation and Shortage of Industrial Capital', 31 Dec. 1948; MSS200/F/3/E3/3/10, FBI Home Economic Policy Committee Report, July 1948. This notion of finance 'failing' industry was to be revived in the 1970s, leading to the creation of the National Enterprise Board which did have some success as a 'venture capital' provider, though not in its original, intended role

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Ultimately, the NIB was not needed for the macroeconomic purposes originally assigned to it in the circumstances of the 1940s, and would have been ineffective for microeconomic ones. If the government really wanted to control company-level investment decisions, there would have been little choice but to have a direct role in company decision-making – a proposal made by the young Harold Wilson, President of the Board of Trade, in 1950, by then too late to have any impact on Labour's policies.[61]

Finally, Labour's failure to reform the financial system to a significant degree may be illuminated by comparison with the experience of France. Zysman has persuasively argued that the role of the financial system in attempts at economic planning in post-war Europe was crucial, and contrasts the British and French experience:

> As an alternative to administrative planning, the British might have turned the financial system to the ends of planners, allocating credit as a means of distributing resources, and created a trained cadre of bureaucrats prepared to use these instruments. Indeed the French planners had turned the credit allocation precisely to avoid being trapped in existing bureaucratic commitments and trade association arrangements . . . the Labour government, then, adopted planning but eschewed one of the most powerful instruments of planning: credit planning through the financial system.[62]

Zysman ascribes this difference to Labour and civil service ignorance of finance, a belief that wartime administrative controls could be used to 'outflank' the City, and the fear of capital flight in such a precarious international economic situation.[63] All these points seem fair, though to them should definitely be added the highly liquid position of British industry, which made the control of external funds much less important in determining investment behaviour than in cash-starved French firms. Labour's political weakness in this area was thus heavily compounded by this peculiar feature of the economy it was attempting to control.

as an interventionist body across the breadth of manufacturing industry (Tomlinson, *Government and the Enterprise*, ch. 9).

[61] PRO PREM8/1183, 'The State and Private Industry', 4 May 1950.

[62] J. Zysman, *Governments, Markets and Growth: Financial Systems and the Politics of Industrial Change* (Ithaca, 1983), pp. 183–4.

[63] Ibid., pp. 184, 185.

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